

**An updated market gap assessment in the field of financial accessibility:
Progress report on implementation of financial instrument programs**

RIGA, 2017

Introduction

The sub-paragraph 25.1. of the Regulations of the Cabinet of Ministers No. 118 “Regulations on the implementation of measures for financial instruments and Fund of Funds within the operational program’s “Growth and Employment” specific support objective 3.1.1. “Facilitate formation and development of small and medium-sized enterprises, in particular in manufacturing and RIS3 priority sectors” and the specific support objective 3.1.2. “To increase the number of fast-growing entrepreneurs”” of March 1st, 2016 (hereinafter - Cabinet Regulation No. 118) determines that the Ministry of Economics (hereinafter - MoE) is obliged to revise and to correct the assessment of market failure annually by May 1st of the current year under the approved state aid programs. By contrast, Article 37 (2) (g) of the Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund provides that provisions allowing for the ex ante assessment to be reviewed and updated as required during the implementation, if ex ante assessment may no longer accurately represent the market conditions existing at the time of implementation. Therefore, in the assessment of market failures in the field of financial accessibility (Access to finance, ex ante assessment, Latvia) (approved by the meeting for the programming period of 2014-2020 of the Supervisory Committee of the European Union Structural Funds and the Cohesion Fund on April 30th, 2015, protocol No. P-2015/UK/1, paragraph 6) determine the revision of European Union financing, financial instruments, if necessary.

National as well as European Union legislation does not determine the form of updating the assessment of market gap in the field of financial accessibility, therefore the updated assessment of market gap in the field of financial accessibility has been prepared in the form of an informative report.

In the 1st quarter of 2017, the MoU has evaluated the market situation of the financial sector and available financial resources regarding the availability of funding for micro, small and medium-sized enterprises and the progress of the implementation of existing financial instruments, and concludes that the market situation has changed in relation to commercial banking lending activities, as well as new tools are available on the market that complement the existing ones. The MoU concludes that, based on the progress made so far in implementing the experience and the programs, it is possible to achieve the goals set in the field of financial security more effectively by using an appropriate source of funding.

Consequently, **the aim of this informative report** is to describe the changes that took place in the market compared with the assessment of market failures approved on April 30th, 2015 in the area of financial accessibility, pointing to the current financial market situation and outlining the necessary changes in financial instruments for the programming period of 2014-2020 of EU funds, including the analysis of the size of the amount of ERDF funding available for financial instruments in comparison with the current situation and achieved results. The analysis also concludes that there is no need to change the types of financial instruments of EU structural funds for the programming period of 2014-2020. The analysis concludes that there has been a change in the market situation in specific segments, details of the implementation of a particular financial instrument, as well as the need to change a certain amount of ERDF funding.

1. Available financial instruments and implementation progress

Within the framework of the financing of the EU structural funds for the period of 2014-2020, support to small and medium-sized enterprises in the form of financial instruments is provided within the framework of operational program's "Growth and Employment" Priority Axis 3 "Competitiveness of small and medium-sized enterprises". These financial instruments are co-financed by the ERDF funds, provided in the operational program. For several financial instruments, in addition to the ERDF funds, the recycled funds of the financial instruments programs of the previous programming periods of the EU Structural Funds (2004-2006 and 2007-2013) has been allocated, totalling in 14.2 million EUR.

During the programming period of 2007-2013, in addition to the EU funds, 44.1 million EUR from recycled funds and interest income from using free funds were spent on operations. This way, significant additional funding was provided to support small and medium-sized enterprises.

It should be noted that reimbursed funding from the financial instrument programs from the previous programming period will be available also in the future, which could be used as co-financing mechanism to the current period programs additional to the ERDF funding. The use of recycled funding in financial instruments is more effective, as the requirements of the control system are relatively smaller and the administrative burden is much lower, but at the same time it is possible to achieve the same objective as with the funding of ERDF. MoE stresses that recycled public funding is not a subject to all the regulatory requirements in place for ERDF financing. Thus, recycled public funding is more flexible resource considering both allocation and supervision processes. This corresponds both to the institution allocating financial resources (as regulation of structural funds is not applicable) and to the beneficiary, who is not the subject to the demands set in the ERDF regulation.

The objectives of the financial instrument programs of the programming period of 2014-2020 are to facilitate the establishment and development of SMEs, in particular in the manufacturing industries and in the priority sectors of RIS3 (Specific objective (hereinafter – SO) 3.1.1), and to increase the number of fast-growing companies (SO 3.1.2). All financial instrument programs are developed by the Responsible Institution - the Ministry of Economics and their supervision is ensured by the Co-operation institution - the Central Finance and Contracting Agency. The business plan foresees the following financial instruments from the ERDF funding:

Table 1
Granted public and private funding for the implementation of financial instrument programs for the period of 2014-2020.

Financial instrument	Total funding, M EUR	ERDF funding, M EUR	Private funding, M EUR	Other funding, M EUR
Growth capital funds	53,75	30.0	23,75	0
Seed venture capital funds	44,8	30.0	14,8	0
Acceleration funds	16,375	15.0	1,375	0
Business angel co-investment fund	10.0	10.0	0	0
Parallel loans	21.2	7.0	9.2	5.00 (07-13 recycled funding)
Loan guarantees	22.2	15.0	0	6.00 (07-13 recycled funding) 1.16 (04-06 recycled funding)
Start-up and micro loans	32.4	7.0	23.0	2.0 (07-13 recycled funding)
Total	200,7	114.0	72,1	14.16

The planned state aid in the form of financial instruments covers all identified market failures in the area of funding availability for economic operators at different stages of their development. The main purpose of the state aid is to provide support to the extent of promoting market development while not distorting competition and without competing with the private sector.

The results of the programming period of 2007-2013 show a stable demand for financial instruments. Consequently, during the programming period of 2014-2020, similar financial instruments are offered both for starting a company and for its various development stages.

1.1. Loan guarantees

By the end of October 2016, loan guarantees were available under the programming period of 2007-2013. For the period a total of 564 loan guarantees were issued amounting to 158.51 million EUR, providing access to commercial bank loans of 426.26 million EUR. Loan guarantees have been mainly granted to manufacturing companies.

Also during the programming period of 2014-2020 enterprises have access to loan guarantees for starting a business and development in situations when the company's own funds are not sufficient to attract the necessary financing from commercial banks or the enterprise is classified as too risky.

The program has been in operation since June 2016 and until May 31st, 2017, already 152 loan guarantees have been granted for 27.2 million EUR, reflecting consistently high demand for these types of financial instruments.

In order to reduce the administrative burden and facilitate issuing loan guarantees for small projects (up to 150 000 EUR), at the beginning of 2017, Development Finance Institution ALTUM (hereinafter – Altum) launched a new form of cooperation with commercial banks in issuing loan guarantees, which significantly reduces the time and administrative resources necessary to provide loan guarantees, thus they are more affordable for entrepreneurs and serves as additional collateral for small loans.

In addition, on September 12, 2017 the state support program for portfolio guarantees was approved by the Cabinet of Ministers, and this program is a new financial instrument in Latvia. The support program will be implemented by Altum, which will select credit institutions in the open selection process. Those credit institutions without Altum's direct involvement will be able to grant companies a state guaranteed loan within certain funding limits. Portfolio guarantee will be able to apply for investment, working capital loans and leasing up to 250 thousand euros.

Taking into account the implemented changes to the loan guarantee instrument, as well as implementation of portfolio guarantees in the beginning of 2018, the Ministry of Economics forecasts that the financial services guarantee portfolio will grow significantly in the future in the area of small loans, thus improving the financial accessibility of small and medium-sized enterprises for loans up to EUR 150 000. In turn, individual guarantees will be provided for larger amounts of financial transactions.

In addition, in the framework of the European Fund for Strategic Investments Altum in 2016 has signed a contract with the European Investment Fund for the provision of guarantees to innovative enterprises for commercial bank loans (Innovfin program), and in September 2017 Altum has signed a contract for provision of guarantees for Altum issued loans for high risk projects up to 150 thousand euro. Within Innovfin program currently there are 8 guarantees issued for a total amount of 1.5 million euro.

1.2. Start-up and micro loans

The start-up and micro loan program is an important form of state aid, given that private sector players often do not fund start-ups due to high risks, uncertainty and insufficient historical financial flows.

Already in the programming period of 2007-2013, the start-up program was one of the most popular state support programs for young entrepreneurs, and with its help many new and now popular small and medium-sized enterprises started to operate in Latvia.

In total, during the programming period of 2007-2013, 1559 start-up loans were issued for a total amount of 30.79 million EUR of which loan amounts make up 27.74 million EUR and grants for interest rate subsidies make up 3.05 million EUR.

As of June 2016 loans for the implementation of viable business projects - investments and current assets - are being provided under the programming period of 2014-2020. Loans are issued to companies, not older than 3 years of the date of establishment and the maximum loan amount is EUR 150 000.

During the programming period of 2007-2013 micro loans were issued from July 2014 through both Altum and financial intermediary services. Overall, until the closure of the period of 2007-2013, 221 micro loans totalling 2.76 million EUR were issued.

Similarly, during the programming period of 2014-2020, entrepreneurs have access to micro loans (up to 25 000 EUR) for the establishment and growth of a small business and by the end of May 2017, 48 micro loans have been issued amounting to 0.6 million EUR.

In addition to the European Union Structural Fund programs, Altum is currently submitted application to apply for loans from the EU Programme for Employment and Social Innovation (hereinafter - EaSI) micro credit program, and is currently communicating with the European Investment Fund (hereinafter -EIF) on the conclusion of a contract for 5 to 10 million EUR.

1.3. Parallel loans

For the programming period of 2014-2020, the companies have access to parallel loans that are substantially similar to the mezzanine loans offered for the programming period of 2007-2013. This is an additional loan, which serves as a co-financing instrument to a bank loan, in cases where the conditions of banks require a larger stake than an entrepreneur is able to provide.

The program has been in operation since July 2016 and, by the end of May 2017, 6 loans have been issued for a total of 0.66 million EUR.

Also during the programming period of 2007-2013, the program was not very popular and several marketing events were organized to introduce entrepreneurs to the availability of such a service. Overall, 28 mezzanine loans totalling 15.2 million EUR were issued during the period of 2007-2013.

1.4. Venture capital instruments

For the programming period of 2014-2020, companies are also offered early-stage and high-risk investment products. Continuing the experience of the period of 2007-2013 and taking the market developments into account, it is planned to offer several venture capital instruments that will be introduced through open financial selection of financial intermediaries.

Technology accelerators - the program is designed for innovative start-up companies to create and develop business ideas, companies and products, with a purpose of boosting their growth and competitiveness, especially for technological and industrial projects. Pre-seed funding of

up to EUR 50 000 will be provided for company development, consultancy and product development, research, evaluation and validation, and seed funding of up to EUR 250 000 will be provided for companies that have successfully completed the pre-seed investment phase, for further growth, product development and economic activity. The terms of the program have been approved and a selection process for financial intermediaries is finished and currently contracts with financial intermediaries are being concluded. It is expected that acceleration programs will be launched in the beginning of 2018.

Seed, initial and growth risk capital funds - the program is intended for investment in new and innovative enterprises with high growth potential in the early stages, in which traditional financiers refrain from investing due to high risk. Seed and initial capital investments can be a contribution to the company's equity and quasi-equity. The terms of the program have been approved and the procurements of financial intermediaries are in the process. Considering the attraction of private co-financing, funds are expected to start their operations in mid-2018.

Business angel co-investment fund - the program was planned to be implemented in cooperation with the European Investment Fund, but on November 21st, 2016, a refusal was received from the European Investment Fund based on the undeveloped network of business angels in Latvia and, accordingly, the insufficient demand in the market. On March 17th, 2016, to promote the activities of the business angels and provide alternative sources of finance to funding from commercial banks, a cooperation agreement was signed between Altum and the society "Latvian Business Angels Network", in which Altum and business angel financing were combined to provide start-ups with the opportunity to receive funding or receive it at a higher rate when there is insufficient co-financing and collateral for a loan of a commercial bank. Within the framework of the pilot project, five joint venture agreements have been concluded so far on a share of Altum funding of 144 500 euros, representing 4.8% of the Altum budget available for cooperation in the program - a total of 3 million euros.

In addition to the Structural Funds programs of the European Union, **the Baltic Innovation Fund** (hereinafter - BIF) also offers venture capital investments. BIF is an innovative Baltic-wide investment initiative, designed to increase the availability of private and venture capital financing for companies in the Baltic States. BIF finances and administers venture capital and start-up funds that carry out early-stage venture capital investments in small and medium-sized enterprises in the Baltic States, investments from 3 to 15 million euros.

2. Evaluation of the market situation

2.1. Availability of funding: demand dimension

Assessing the problems of financial availability in Latvia and the European Union, as well as analysing the existence of market failures, the data, provided by the Financial and Capital Market Commission and the data of the Bank of Latvia was analysed, the annual study "Survey on the access to finance of enterprises" (SAFE)¹, by the European Commission and the European Central Bank, the study "The Competitiveness Report of Latvia, 2015, Financial Availability"², conducted by the think tank "Certus", as well as the data provided by the Association of Latvian Commercial Banks as part of the credit committee from April 3rd, 2017,

ECB Survey on the Access to Finance of Enterprises in the euro area – October 2016 to March 2017. Available at: <https://www.ecb.europa.eu/pub/pdf/other/ecb.accesstofinancesmallmediumsizedenterprises201705.en.pdf?0543ff3b129e346a10363074a651bd98>

Think tank "Certus". Latvia's Competitiveness Report, 2015, Financial availability. Available at: http://certusdomnica.lv/wp-content/uploads/2015/07/CertusFinansuPieejamiba_2015.pdf

were reviewed. This part of the study was carried out in order to conclude whether market failures in Latvia still exist, and therefore justifies the state intervention in a particular sector.

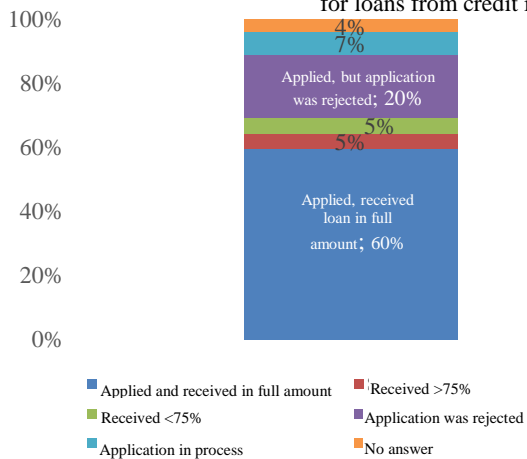
The annual study “Survey on access to finance of enterprises” (SAFE), by the European Commission and the European Central Bank, analyses the situation in the Member States, including 186 surveyed micro, small and medium-sized enterprises in Latvia.

The study concludes that there still are problems with financial accessibility among micro, small and medium-sized enterprises. Namely, bank loans and credit lines continue to be the main source of financing for micro, small and medium-sized enterprises in the Member States of the European Union - these types of loans account for respectively 54% and 51% of the total SME funding structure. The European Commission and the European Central Bank, as a solution to this funding request, have pointed out that initiatives to support access to finance for micro, small and medium-sized enterprises have been developed at the level of the European Union to foster financial accessibility.

Figure 1
Applications of micro, small and medium-sized enterprises for loans from credit institutions, in %



Figure 2
Status of micro, small and medium-sized enterprise applications for loans from credit institutions



It should be noted that 11% of Latvia's micro, small and medium-sized enterprises in this study refer to the availability of funding as the most important problem of the company. Evaluating the results of the study, it is concluded that micro, small and medium-sized enterprises in Latvia have more problematic access to funding than the average in 28 EU Member States. According to a survey, 11% of the micro, small and medium-sized enterprises do not apply for a loan because of a possible rejection, whereas 20% of applications are rejected, which is one of the highest figures in the European Union.

The study also concludes that a similar situation can be seen with applications for credit lines and overdrafts, which suggests that micro, small and medium-sized enterprises are having difficulty in obtaining the necessary funding. The amount of funding necessary for the growth of micro, small and medium-sized enterprises in 45% cases is up to 100 000 euros, and the most frequent factors limiting the attraction of funding are insufficient collaterals or guarantees (22% in Latvia, 15% in the EU) and too high interest rates / costs (12% in Latvia, 11% in the European

Union). Only 24% of micro, small and medium-sized enterprises in Latvia have indicated that there are no barriers to obtaining the necessary funding, while the average level in the EU is 44%.

The financial market trends and the aspects of financial accessibility have been analysed in the Certus study³, which uses the industry expert interview method to assess the financial accessibility aspect of SMEs. The study concludes that the problem of financial accessibility exists mainly for the financing of micro, small and medium-sized enterprise investments, and, in contrast to the above-mentioned international study, it is concluded that the main reasons for non-receipt of loans may be (1) shadow economy activities of the companies (reduces the credibility of financial data); (2) high potential for non-repayment of borrowed debts (through insolvency proceedings); (3) slow and ineffective recovery of bad loans (slow litigation). As justified in the assessment of market disadvantages in the field of financial accessibility drawn up by the Ministry of Economics a significant problem for SMEs still is (4) insufficient collateral for the receipt of commercial loans, which is solved within the framework of programs implemented by joint stock company “Development Finance Institution Altum”.

Entrepreneurs wish to receive more public support - more favourable and stable tax policies, wider financial support programs and various types of state guarantees.

According to the conclusions, presented by the Association of Latvian Commercial Banks on April 3rd, 2017, on the development of lending, the most common reasons why companies do not receive funding are: (5) insufficient cash flow for planned liabilities, (6) owner and business experience, (7) reputation, (8) high sector / business risk, insufficient collaterals, (9) age of the company, (10) insufficient financial stability, (11) lack of economic justification in the business plan.

The state policy on business improvement is aimed at reducing the significance of identified barriers. The Action Plan for business environment improvement for ⁴, developed by the Ministry of Economics, includes a set of measures regarding the implementation of contractual obligations and improvement of the business termination that would enhance the quality of supervision of the insolvency and legal protection proceedings. If the measures provided in the plan are implemented, it is expected that the implementation of reforms will reduce the significance of these risks and it is expected that the market activity will increase. Consequently, the positive trend towards improving the external environment will be outlined, which will accelerate the growth of lending. Although positive market trends have actually been identified, and in spite of future work to improve the situation, the current situation shows that there are still shortcomings in the market regarding the availability of funding, as evidenced by the studies previously examined. Considering the results of the above-mentioned studies and the data presented in relation to the initial assessment of market failures in the area of financial accessibility, approved on April 30th, 2015, it can be concluded that there is a market failure in terms of the availability of funding.

Considering the above-mentioned general conclusion that there are still shortcomings in the market regarding availability of funding, the following part of the study will analyse the supply dimension and specific market segments as well as specific state aid programs and within an in-depth analysis identify whether it is possible to detect equivalent dynamics.

3 Think tank “Certus”. Latvia’s Competitiveness Report, 2015, Financial availability. Available at: http://certusdomnica.lv/wp-content/uploads/2015/07/CertusFinansuPieejamiba_2015.pdf

4 Decree No 125 of March 17th, 2017 by the Cabinet of The Action Plan for business environment improvement”

2.2. Availability of funding: supply dimension

Evaluating the supply dimension of availability of finance, the Ministry of Economics has analysed the data provided by the Financial and Capital Market Commission in order to analyse the specific market segments in detail and to analyse the progress of specific financial instrument programs. It has been concluded that there are gaps in the market from the demand perspective, thus the analysis of the supply dimension will help to identify the particular sectors and conclude what kind of state intervention is necessary. In turn, the analysis of the results of the financial instrument programs will indicate the returns of a specific programs and possible improvements.

According to the data of the Financial and Capital Market Commission (hereinafter - FCMC), the loan portfolio of resident companies for the 1st quarter of 2017 amounted to 6 421 729 thousand euros, which has increased by 4.8% as compared with the 3rd quarter of 2016.

Figure 3
Commercial bank loan portfolio for enterprises by category, in billions of Euro

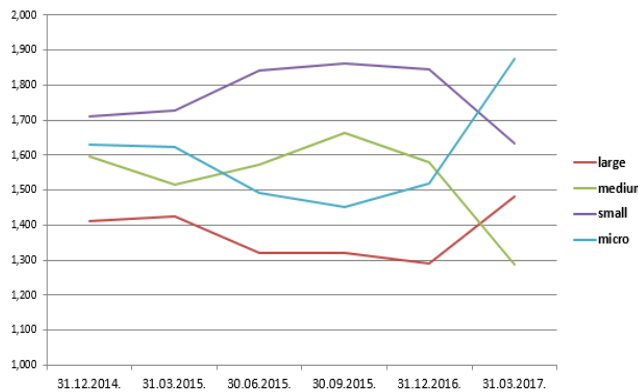
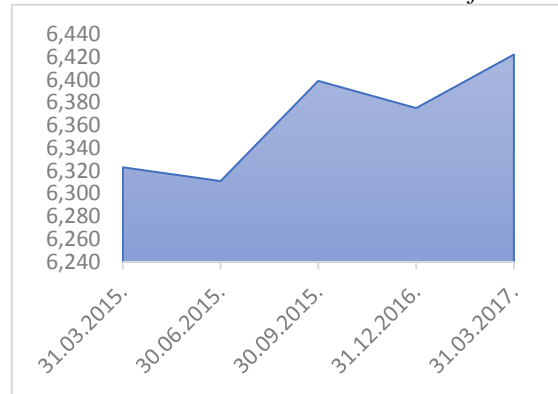


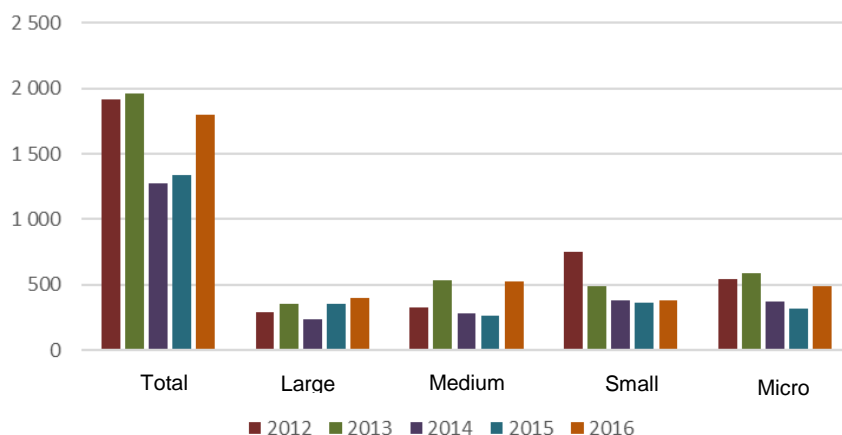
Figure 4
Commercial Bank Loan Portfolio, in billions of Euro



According to FCMC, the corporate lending represents a significant part of the total loan portfolio. In the 1st quarter of 2017, the lending of resident enterprises amounted to 50% of the total resident loan portfolio, while the share of SMEs in the corporate loan portfolio amounted to 74.6% or 4 793 671 thousand euros. The volume of new loans issued for corporate clients in this period amounted to 24% of the total amount of loans granted to residents (non-banks), and the share of SMEs in loans granted to enterprises amounted to 59.3% or 71 581 thousand euros. Although it has been found that micro, small and medium-sized enterprises have problems obtaining financing from commercial banks, according to the data from FCMC, a significant increase in corporate lending is observed in 2016 (see Figure 3). **In 2016, companies received 34% more financing, mainly due to the increase in the volume of lending in the sector of micro and medium-sized enterprises - in these segments, the lending grew by 48%.**

Changes in the amount of lending in 2016 indicate the need to revise the scope and sources of funding of the programs in accordance with the current market situation in order to ensure greater flexibility in the use of public financing and thus making financial products more competitive.

Figure 5
Newly issued loans, based on size of enterprise, mil. EUR



When assessing the activity of commercial banks in the segment of small loans, including micro lending (see Figures 6 and 7), there is an increase in the volume of lending. The increase in the volume of loans in client contracts, where the amount of the client's obligations is up to 30 thousand euros has increased by 70% in 2016 compared to 2015, while the volume of loans in client contracts, where the amount of the client's obligations is from 2 thousand up to 200 thousand euros has increased by 67% in 2016 compared to 2015. At the same time, it should be noted that the rapid increase can be partly explained by the relatively low base value.

Figure 6

Amount of the client's obligations under 30 000 EUR (total, mil. EUR)

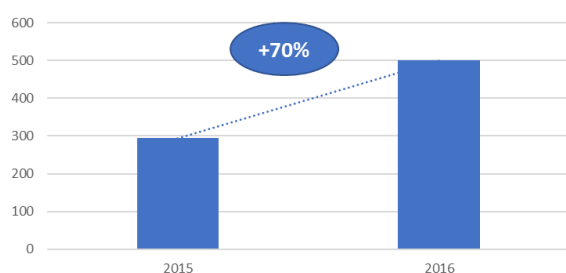
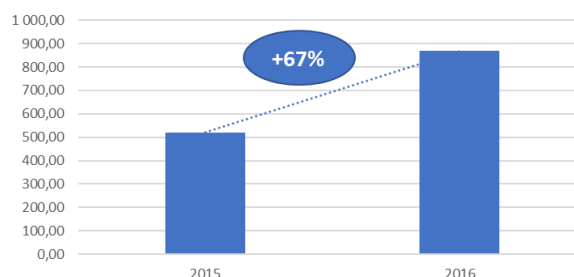


Figure 7

Amount of the client's obligations from 2000 to 200 000 EUR (total, mil. EUR)



This increase in the volume of lending in the field of small and micro lending may be explained by various reasons, first of all, by the overall increase in lending compared to 2015, the increased activity of commercial banks in this segment, as well as the overall economic growth. The Ministry of Economics predicts that growth of GDP in 2017 could reach at least a 3%, in addition, the growth rates of output of manufacturing and construction sectors in the first half of 2017, as well as the growth of total exports, justify the growth forecasts.

According to the estimates of the Bank of Latvia, it is⁵ planned that the lending volumes and commercial banking activities in these segments will also increase. It is planned that the

Bank of Latvia. Review of macroeconomic developments. June 2017. Available at: <https://www.bank.lv/lb-publikacijas/makroekonomisko-norisu-parskats>

commercial bank activity in the lending to companies will increase, as well as the volume of lending in 2017 and subsequent years. Bank of Latvia indicates that the newly issued loans to non-financial corporations over the seven months from October 2016 to April 2017 exceeded the respective indicators of 2015 and 2016 by 13.5%. Bank of Latvia also points out that the growth of a stable corporate loan portfolio is supported by an increase in investment, in which an important role is played by the investment activities of the EU Structural Funds, as well as the loan guarantee program, implemented by Altum.

Figure 8
Increase in lending in Latvia

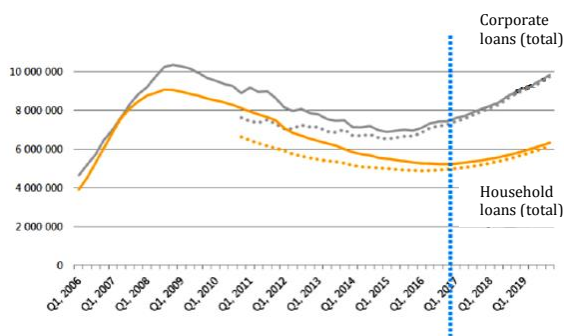
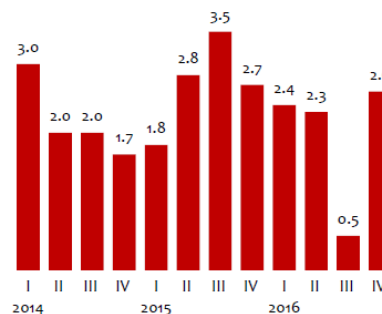


Figure 9
GDP dynamics (annual change in % against previous period)



Taking into account the significant changes in the lending segment of the micro, small and medium enterprises, the different focus and target groups of Altum and the commercial banking sector and based on lending data provided by the Bank of Latvia and the Financial and Capital Market Commission, the Ministry of Economics concludes that the micro credit segment shows significant differences compared to the SME Access to Finance ex ante Assessment for Latvia, moreover considering the complementary role of the services and products offered by Altum and its impact on the common market activity and commercial bank segments.

Lending to micro, small and medium-sized enterprises: results achieved and risks identified

Altum offers micro and start-up loans to entrepreneurs since June 2016. Until June 30th, 2017, 188 start-up loans have already been issued amounting to 3.77 million EUR, of which 66 were issued to start new business, 66 loans have been issued to companies during their first year and 55 loans for companies in their second and third year of operations. Until June 30th, 2017 53 micro loans amounting to 0.67 million EUR were also issued. The demand dynamics until the end of April 2017 within the framework of the micro lending and start-up program is summarized in Tables 1 and 2.

Table No. 1
Amounts of granted, issued loans and contracts concluded in the micro lending program within the framework of Regulation No. 328 of the Cabinet of Ministers

Time period	Loans granted		Concluded contracts		Loans issued	
	Number	Amount, in EUR	Number	Amount, in EUR	Number of first issuance	Payments made, in EUR

08.06.2016 ⁶ - 31.07.2016	7	77,270.00	6	67,270.00	2	14,985.00
01.08.2016- 31.08.2016	4	36,542.00	4	44,992.00	6	62,850.00
01.09.2016- 30.09.2016	4	50,647.00	3	26,197.00	2	40,510.72
01.10.2016- 31.10.2016	5	58,586.00	5	71,286.00	8	65,100.91
01.11.2016- 30.11.2016	3	43,950.00	4	44,740.00	3	30,840.00
01.12.2016- 31.12.2016	5	62,050.00	4	48,550.00	2	36,934.36
01.01.2017- 31.01.2017	1	25,000.00	3	51,010.00	3	28,117.10
01.02.2017- 28.02.2017	8	132,232.00	3	37,500.00	3	31,262.07
01.03.2017- 31.03.2017	6	60,900.00	8	128,732.00	9	139,613.35
01.04.2017- 30.04.2017	4	51 500.00	6	64,900.00	5	51,817.34
01.05.2017- 31.05.2017	2	19 600.00	2	20 500.00	1	42 892.14
01.06.2017- 30.06.2017	4	59 650.00	1	24 650.00	1	17 896.25
Total:	53	677 927.00	49	630 327.00	45	562 819.24

Table No. 2

Amounts of granted, issued loans and contracts concluded in the business start-up program within the framework of Regulation No. 328 of the Cabinet of Ministers

Time period	Loans granted		Concluded contracts		Loans issued	
	Number	Amount, in EUR	Number	Amount, in EUR	Number of first issuance	Payments made, in EUR
until 31.07.2016.	14	265,540.00	8	82,340.00	6	66,330.53
01.08.2016- 31.08.2016	13	222,794.36	17	351,004.36	7	120,286.42
01.09.2016- 30.09.2016	11	131,695.00	9	115,400.00	14	138,713.22
01.10.2016- 31.10.2016	15	353,704.00	15	300,007.00	8	90,570.59
01.11.2016- 30.11.2016	23	261,210.00	20	310,670.00	21	225,203.80
01.12.2016- 31.12.2016	20	582,486.58	17	453,819.58	19	360,188.39
01.01.2017- 31.01.2017	13	196,466.00	13	227,533.00	10	298,826.93
01.02.2017- 28.02.2017	16	361,253.00	16	264,576.00	19	299,523.77

Loans are granted since the fund stock agreement was signed between Altum and CFCA on June 8, 2016.

01.03.2017-31.03.2017	30	696,366.00	25	695,922.00	17	281,289.07
01.04.2017-30.04.2017	12	256,250.00	19	398,842.00	19	394,305.04
01.05.2017-31.05.2017	12	335 844.00	12	229 767.00	17	500 470.85
01.06.2017-30.06.2017	19	277 220.00	17	341 820.00	18	333 948.88
Total:	198	3 940 828.94	188	3 771 700.94	175	3 109 657.49

By analysing the demand of loans granted within the framework of the micro lending programme, it can be concluded, that on average loans in the amount of 60,000 euros are granted monthly. According to data of the Bank of Latvia, the total amount of customer liabilities up to 20 thousand euros in the portfolio of loans of commercial banks for resident companies in 2016 comprises 34,987,732 euros (see: graph 10), the amount of payments made within the micro lending programme corresponds to 1.4% of the total loan balance of commercial banks. At the same time, it must be indicated, that conditions for granting loans in commercial banks and programmes administered by Altum differ significantly, similarly as the target groups receiving the particular products. Diversifying sources of finance by replacing ERDF financing with another financial resource (recycled funds) would promote the competitiveness of the micro lending product thus as receiving of micro credits could be improved and facilitated by mitigating fulfilment of requirements and administrative burden.

Figure 10

Loans granted by credit institutions to SMEs divided by the company size

Quarter	Micro enterprise		Small enterprise		Medium enterprise		Total SMEs	
	Actual amount of client's liabilities (EUR)	Number of contracts	Actual amount of client's liabilities (EUR)	Number of contracts	Actual amount of client's liabilities (EUR)	Number of contracts	Actual amount of client's liabilities (EUR)	Number of contracts
2015								
Q.1	25 727 983,05	6 714	12 831 304,21	3 013	1 178 692,40	670	39 737 979,66	10 397
Q.2	26 500 948,29	6 176	12 345 190,60	2 966	1 047 728,60	664	39 893 867,49	9 806
Q.3	26 421 400,56	6 193	12 428 594,83	2 974	1 235 654,37	661	40 085 649,75	9 828
Q.4	25 581 975,49	6 145	11 787 607,25	2 907	1 102 522,35	683	38 472 105,08	9 735
2016								
Q.1	25 574 367,46	6 006	12 086 632,32	2 895	1 077 348,74	691	38 738 348,52	9 592
Q.2	26 932 263,68	5 872	11 505 604,45	2 892	1 037 839,42	678	39 475 707,55	9 442
Q.3	26 459 421,44	5 925	10 563 389,39	2 822	931 549,47	683	37 954 360,30	9 430
Q.4	28 565 295,07	6 429	5 421 533,72	1 880	1 000 903,30	843	34 987 732,09	9 152

On average loans in the amount of 245,434 euros are granted monthly within the framework of the start-up programme. According to data of the Bank of Latvia on small loans which corresponds to average amount of loan within the start-up programme (up to 100 thousand euro), the actual amount of client's liabilities in the portfolio of commercial banks for resident companies constitutes 224,045,838 euros. Considering, that commercial banks are conservative in terms of granting loans for start-ups due to insufficient period of operation and credit history and insufficient cash flow, ensuring of state support programme for start-ups is very crucial in terms of access to finance. To make the start-up loan programme more competitive by easing the granting procedure and mitigating the administrative burden, it is significant to diversify financial resources, reducing the amount of ERDF financing and replacing it with alternative sources of financing (for example recycled funding). By ensuring the use of recycled financial resources it would be possible to support more beneficiaries with a minimum administrative burden.

By assessing the progress of start-up and micro lending programme in accordance with paragraph 17 of Regulation of the Cabinet of Ministers No. 328, Ministry of Economics estimates, that financing allocated for the start-up and micro lending programmes will be fully acquired by December 31st, 2020, the term set for conclusion of loan contracts. At the same time it is important to diversify sources of financing thus improving access to programmes and mitigating administrative burden, which derives from the provisions set in the EU regulation on state aid, which restrict use of ERDF financing. The restrictions apply to the time-limit of aid granted as well as the administrative demands set both for the beneficiary and Altum.

As mentioned previously in the report, in the beginning of 2018 Altum plans to introduce a new product in the market – portfolio guarantees. Taking into consideration the increase of activities of commercial banks in crediting of SMEs this product will even more encourage commercial banks to issue small loans. Also, considering different credit policies and terms of issuing loans of Altum and commercial banks (see: table No. 3), it is important to retain intervention of Development Finance Institution Altum in issuing small loans, at the same time improving the process for issuing and receiving the support by reducing amount ERDF financing and substituting it with other resources not subject to restrictions in terms of issuance and use of financing determined in EU legislation.

It should also be noted that under the Junkers plan, the availability of small loans to companies at the stage of product or service development will be facilitated by the COSME program with the provision of guarantee of the European Investment Fund. Aid in the form of an unsecured loan is available to companies not older than 5 years, for a maximum loan amount of up to 150 thousands of euros. The agreement on the introduction of the COSME guarantees between the European Investment Fund and Altum was concluded in September 2017.

In addition, to promote micro lending Altum plans to expand its cooperation with the European Investment Fund within the framework of the EU program for Employment and Social Innovation (EaSI) by providing guarantees for micro loans.

Table No. 3
Conditions for receiving of microloans in Altum and commercial banks

	Altum	CITADELE	SEB	SWEDBANK
Maximum amount of loan	Up to 25 000 EUR	1,000 - 20,000 EUR	2,000 - 20,000 EUR	Up to 15,000 EUR
Special conditions	-	Up to 100% of the company monthly turnover, without additional collateral	70% of the company monthly turnover in SEB bank	100% of the company monthly turnover
Borrower's co-financing	10% of 7,000 EUR	0%	0%	0%
Interest rate	5-8% + SC	starting from 12% a year	Starting from 15% + 3 month EURIBOR	14-20%
Loan term	Up to 8 years	For 1 year with an option to extend the term	up to 3 years	1-5 years
Collateral	Up to 5,000 EUR, commercial pledge is not necessary.	Company owner guarantee	Company owner guarantee	Company owner guarantee
Commission	0.5% (minimum: EUR 50)	2% of the amount, but not exceeding 150 EUR	1%, (min. 150.00 EUR	1.5% of the amount, min. EUR 150.00; applying and concluding a contract

				through online banking, min. EUR 100.00
Application examination period	Up to 30 days	1 day from signing an application	2 - 3 days	within 1 day
Documents to be submitted	Large amount of documents to be submitted	1. Loan application; 2. VAT declaration (6 months)	1. Completed credit application 2. Copy of passport or identity card (ID card) of the signatory; 3. Document certifying signatory rights; 4. Last annual report with explanation of the balance and profit and loss statement items	Electronic application, if SWEDBANK online banking is available. If not, the application has to be signed on site at the bank.

It also must be noted, that according to the Access to Finance ex ante Assessment, ERDF financing of 3 million euros is planned for establishment of indirect micro lending support programme and introduction thereof with intermediation of savings and loan associations. At the Meeting of the Cabinet of Ministers of January 24, 2017, the informative report of the Ministry of Finance “On Further Development Perspectives of Savings and Loan Associations” was examined, and it was decided to develop a regulatory framework for second-level cooperative associations of savings and loan associations until 31 December 2017. Development of support programmes is possible only after development of a regulatory framework for second-level savings and loan associations as legal issues related to potential implementation of the programme cannot be foreseen. Due to the fact that new entities will be established as the cooperative banks, there is no possibility at present stage to estimate costs associated to introduction of the programme.

Therefore, implementation of state support programme for supporting operation of savings and loan associations for second level is impossible before (1) development of a relevant regulatory framework for second-level savings and loan associations, and (2) without implementing measures for strengthening capacity of savings and loan associations, training of employees, as well as (3) for promotion of public understanding about the role of savings and loan associations in the national economy as a whole; however, these measures cannot be applied within the framework of financial instruments. Taking into account the time constraints for using of ERDF financing and the necessity to achieve specific target indicators, for the introduction of support programme for second level savings and loan associations alternative sources on financing (such as funds returned from ERDF investments) should be considered or financing from ERDF allocated until 2023.

Conclusions:

- ⇒ While assessing data about the market situation, it has to be noted, that market gap in the segment of small loans still exists. At the same time, demand for small loans and activity of commercial banks in granting of small loans is increasing. Considering the different focus of operation of Altum and commercial banks, as well as the different credit policies and conditions for issuing and receiving of loans, activities of Altum can be seen as supplementary to activities of commercial banks. In order to promote activity of commercial banks in granting of small loans, introduction of new support instruments is important. In addition, to improve the conditions for and receipt of microloans and start-up loans granted by Altum, it is necessary to reduce use of ERDF financing by replacing it by another source of finance, which does not imply the conditions and

limitations set in the EU legislation for use of ERDF financing. Considering the performance results of Altum within micro lending and start-up loan programmes, no risks of non-acquisition of ERDF financing and fulfilment of specific target objectives can be identified.

- ⇒ Based on the previously identified risks regarding development of state support programme for development of savings and loan associations, without development of legal framework, implementation of indirect micro lending programme is impossible, preserving the forecast initially included in the Access to Finance ex ante Assessment.
- ⇒ **Considering the afore mentioned argumentation and with an objective to promote competitiveness and access to micro lending and start-up loan programmes implemented by Altum, it is important to improve the process of granting small loans. Therefore, the ERDF financing available for the activity 3.1.1.4 “Micro lending and loans for start-ups” equal to 12 million euros has to be reduced, respectively, reducing the financing by 3 million euros within the indirect micro lending programme and by 5 million euros within the framework of the direct micro crediting – loans for start-ups programme, replacing the financing of 2,5 million euros by recycled finance of financial instrument programs. The amount of such recycled funding is determined by the provision of guarantees in the COSME program and the implementation of the EASI program, thus reducing the amount of risk coverage required for the program and accordingly the funding required.** Reallocation of financing does not imply influence on concluded contracts with recipients.

table No. 4

Actual division of ERDF financing within the activity 3.1.1.4 and proposal for reduction (euro)

Financial products of activity 3.1.1.4	ERDF allotment to date, euro	Proposed reduction of ERDF financing, euro	ERAF result, euro
Indirect micro lending	3,000,000	- 3,000,000	+ 4 000 000
Micro/start-up loans	9,000,000	- 5,000,000	

3. Guarantee instrument: identified risks

ERDF financing planned for loan guarantees comprises 22,000,000 euros, including 15,000,000 euros for implementation of an individual guarantee programme and 7,000,000 euros for the portfolio guarantee instrument. Individual guarantees are provided according to the the framework of the Cabinet of Ministers Regulations No. 997 “On Guarantees for Improvement of Competitiveness of Merchants and Appropriate Agricultural Services Cooperative Companies” of 26 October 2010 (hereinafter – the CM Regulations No. 997).

According to paragraph 27 of the CM Regulations No. 997, the term for provision of loan guarantees is 31 December 2020. Taking into consideration the program results and indicators of acquisition, the Ministry of Economics estimates, that the financing allocated by ERDF will be spent in full amount by 31 December 2020, if the market situation and access to loans of commercial banks do not change significantly.

It should be indicated, that a new model for issuing individual loan guarantees through commercial banks is introduced in order to promote access to individual loan guarantees.

According to operational information provided by Altum, as on 1 February 2017 the guarantee portfolio of Altum consists of guarantees in the amount of 114 million euros, guaranteed by 17 credit institutions or their subsidiaries. 81% of the guaranteed portfolio are ensured by four credit institutions – respectively, 27.9%, 22.5, 19.6% and 11% of the guaranteed portfolio. In 2016, Altum issued 115 guarantees in the amount of 26 million euros, the average amount of one guarantee constituting 226,000 euros. These guarantees secure loans of credit institutions to merchants in the amount of 45 million euros.

Therefore, considering Altum estimates it can be concluded, that no ERDF financing non-acquisition risks exist in the individual loan guarantee programme, because demand for loan guarantees is high, which is confirmed by the number of concluded contracts within the programme.

table No. 5
Amount of concluded loan guarantee contracts in the framework of CM Regulations No. 997

Time period	Concluded contracts	
	Number	Amount, EUR
08.06.2016-30.06.2016 ⁷	3	504,192.00
01.07.2016-31.07.2016	11	962,342.87
01.08.2016-31.08.2016	16	3,497,185.50
01.09.2016-30.09.2016	4	2,562,442.00
01.10.2016-31.10.2016	10	1,083,648.00
01.11.2016-30.11.2016	10	2,462,440.28
01.12.2016-31.12.2016	13	1,631,000.00
01.01.2017-31.01.2017	17	1,282,830.01
01.02.2017-28.02.2017	10	832,193.25
01.03.2017-31.03.2017	13	4,439,875.00
01.04.2017-30.04.2017	26	4,215,982.80
Total:	133	23 74,131.71

It also should be mentioned, that individual guarantees is complemented by a portfolio guarantee programme (state aid rules approved on September 5, 2017), which is a completely new financial instrument in Latvia and will be available for companies in the beginning of 2018. Within the portfolio guarantee scheme, similar as for individual guarantees, a beneficiary receives state aid in a form of guarantee for a financial service provided by a credit institution and subsidiary of credit institution. The purpose of the portfolio guarantee instrument is to guarantee small financial transactions – loans and leasing (up to 250,000 EUR) with the average planned amount of transactions from 75,000 – 150,000 EUR.

For implementation of the portfolio guarantee programme it is planned to allocate the recycled financing of 2007-2013 programming period activities in the amount of 8,000,000, thus releasing a share of ERDF financing, which was initially planned for the portfolio guarantee

Loan guarantees are applied since conclusion of fund contract between Altum and CFCA on 8 June 2016

instrument. Introduction of portfolio guarantees by using the recycled financing instead of ERDF financing is considered to be more efficient, considering that portfolio guarantees comprise a completely new instrument and dynamics and risks of introduction of this instrument cannot be fully predictable.

In addition to these instruments Altum has applied for counter-guarantee instruments of Juncker Plan of the European Investment Fund (hereinafter – EIF):

- InnovFin guarantees comprise a supplementary guarantee instrument on the market and provide an opportunity for innovative companies to receive credit guarantees on more favourable conditions in the framework of the research and innovation programme “Horizon 2020”, financed by the European Strategic Investment Fund and the European Union. Currently, 8 guarantees are issued in the amount of 1.5 million euros, whereas the total amount of contract provides an opportunity to issue guarantees worth up to 30 million euros, thereby providing support to approximately 100 merchants.
- COSME - In September 2017 a contract has been signed with the EIF on the application of guarantees to Altum loans. Under the COSME program, entrepreneurs will be offered a guarantee and the total funding for guarantees is 15 million euro. This program will enable Altum to provide unsecured loans. The aid is available to companies under the age of 5, the maximum amount of Altum's loan is up to 150 thousand euros.

Although there are complementary instruments to individual guarantees, it is essential to ensure the implementation of the individual guarantee program by the end of the planning period 2014-2020, considering the importance of individual guarantees in promoting access to commercial banks loans. In view of the demand for individual guarantees, there are no risks identified of non-acquisition of the ERDF, therefore MoE proposes to increase ERDF financing for the activity 3.1.1.1 “Loan guarantees” by 22 800 000 euros (including the provision for a performance reserve). In this way and per the Altum strategy, a gradual transition from direct lending to indirect financial instruments would be ensured, while ensuring the availability of guarantees to entrepreneurs till 2023 and ensuring a stable acquisition of ERDF funds within the Fund's fund.

table No. 6

Actual division of ERDF financing within the activity 3.1.1.1 and proposal for reduction (euro)

Financial instrument of activity 3.1.1.1	ERDF allotment to date, euro	Proposed increase of ERDF financing, euro	ERAF result, euro
Loan guarantees	15,000,000	+ 22 800 000	+ 44 800 000
Portfolio guarantees	7,000,000	0	
Total	22 000 000	+ 22 800 000	

4. Alternative sources of financing: identified risks

One of alternative sources of financing for implementation of viable financial instruments are investments of business angels. The network of business angels in Latvia is relatively new and undeveloped compared to EU: activity of business angels on the market is low, which is determined by insufficient risk tolerance, lack of knowledge about the sector, as well as

relatively small number of investors. The coefficient of projects selected by business angels in Latvia is 3 times lower than in Great Britain and USA⁸.

One of the leading market participants in the area of business angels is the society LatBan, which has been established relatively recently – on 29 April 2014, and comprises 75 members. The objective of LatBan is to expand and develop the network of investors in Latvia and to support new and perspective projects. Up to this moment, LatBan has received 524 business projects, but the number of investments during this period comprises 24 investments with the total amount of investments constituting 2 million EUR.

With an objective to promote activity of business angels by ensuring risks sharing and addressing the market gap by financing viable projects of a co-financing contract was concluded between LatBan and Altum on 17 March 2016 on implementation of pilot project programme, within the framework of which Altum undertakes to co-finance business projects of business angels in a form of loans. To date the amount of available Altum loan for implementation of a project is 150,000 euros, whereas for projects in manufacturing industry– 250,000 euros on the condition, that the project is co-financed by at least two business angels. Currently there are only 13 applications with the total amount of 657,000 euros were submitted to Altum in the pilot project and only 5 loan contracts have been concluded for the total amount of 144 500 euros.

table No. 7

Actual division of ERDF financing within the activity 3.1.1.3 and proposal for reduction (euro)

Financial instrument of activity 3.1.1.3	ERDF allotment to date, euro	Proposed reduction of ERDF financing, euro	Result of ERDF, euro
Business angel co-investment instrument	10 416,515	-10,416,515	0

According to the Access to Finance, ex ante Assessment, ERDF financing of 10,416,515 EUR is allotted for business angels co-investments within the activity 3.1.1.3 “Business angels co-investment fund”. To introduce the business angel co-investment instrument provided for in the Access to Finance ex ante Assessment, negotiations were commenced with the European Investment Fund as the most appropriate financial intermediary for introduction of the instrument. Considering the results of pilot project and insufficient demand for financing co-investment, the European Investment Fund rejected its participation in introduction of the business angel co-investment instrument.

Taking into consideration the insufficient demand for business angels co-investment and access to support instrument for co-financing of business angels projects there are high risks, that demand within the new financial instrument product – business angel co-investment fund –, provided for in the Access to Finance ex ante Assessment, will be insufficient for acquisition of ERDF financing in the amount of 10,416,515 euros. **Consequently, development and further introduction of the new product – business angel co-investment fund – is not planned and the introduction of a business angel co-investment fund will be overestimated if there will be a significant change in the demand for business angels investments or if there will be high funding acquisition within the Altum and LatBan pilot project and funding will be insufficient to continue the pilot project. Therefore, to mitigate the risks of non-acquisition of the ERDF financing in financial instruments, it is necessary to reduce ERDF within the activity 3.1.1.3 in full amount.**

Risk capital investments are alternative financial resources for commercial banks. They provide financing for those fast-growing companies that do not have sufficient history, co-financing or collateral and thus they are not able to receive financing from the commercial bank for realizing viable business ideas.

During the programming period 2007-2013 with the public co-financing several early-stage and later-stage risk capital funds - seed capital fund (fund manager – Ltd. “AIFP Imprimatur Capital Fund Management”), start-up capital fund (fund manager – Ltd. “AIFP Imprimatur Capital Fund Management”), risk capital fund (fund manager – Ltd. “BaltCap AIFP”), growth capital funds (fund managers – Ltd. “ZGI Capital”, Ltd “FlyCap AIFP”, Ltd. “Expansion Capital AIFP”) were introduced into the market and those funds have made in total 210 risk capital investments of 69 million euro. The investment period for mentioned national funds has expired. It should be noted that Latvia is a co-investor in the Baltic Innovation Fund, where fast-growing entrepreneurs have access to financially large scale investments (up to EUR 15 million), and the investment period within the Baltic Innovation Fund will continue until the end of 2022, for example, for the Baltcap Growth Fund (see Table No.8).

Table No.8

Investment period within Baltic Innovation Fund risk capital funds

	2014	2015	2016	2017	2018	2019	2020	2021	2022
BaltCap PE Fund II									
BPM Mezzanine Fund									
Livonia Partners Fund									
Karma Ventures									
BaltCap Growth Fund									

The risk capital industry in Latvia is developing slowly, and the availability of risk capital investments is significantly influenced by the state intervention, especially for enterprises at their early development stage, as risk tolerance for private investors to invest in early-stage risk capital funds is insufficient. In addition, private investors have insufficient incentives to invest in local risk capital funds. In Latvia is also the lack of smart money, namely the lack of investments that come together with help and advice in creation and development of a business idea. Risk capital in Latvia is a rather insignificant source of financing for companies if compared to other sources of financing - in Europe risk capital investments is 2%, in the United States it is 14%, but in Latvia it is only 0.35% of the total financing of SMEs, which is almost 6 times less than the average in Europe and 40 times less than in the US⁹.

To facilitate creation of new risk capital funds and development of the risk capital industry in Latvia, for the programming period 2014-2020 European Union Structural Funds financing of 75 million euro was allocated to implement early and late stage risk capital instruments, including:

- 1) 15 million euro for acceleration funds (early-stage investments for development of innovative business ideas and non-financial support, such as mentoring, assistance to attract industry experts, partners, next-round investors). In April 2016 state aid rules for acceleration funds were approved by the Cabinet of Ministers, per which introduction of acceleration funds will be ensured by financial intermediaries. Selection of financial intermediaries in the framework of a public procurement procedure was started in February 2017 and three financial intermediaries have been selected to start the acceleration programs in the 1st quarter of 2018;

⁹ Prohorovs, Beizitere, 2015; Prohorovs et al, 2015; MichelBarnier,2012.

- 2) 30 million euro for seed and start-up capital funds (early stage financing for business development). In August 2016 state aid rules for seed and start-up capital funds were approved by the Cabinet of Ministers, per which introduction of seed and start-up capital funds will be ensured by financial intermediaries. Selection of financial intermediaries within the public procurement procedure was launched in June 2017 and currently it is in the process. Considering need for funds to attract private co-financing, as well as progress of the public procurement procedure, it is expected that funds will start their investment period in the 2nd or 3rd quarter of 2018;
- 3) 30 million euro for growth capital funds (financing for enterprises at later stage of development). In August 2016 state aid rules for growth capital funds were approved by the Cabinet of Ministers, per which the implementation of growth capital funds will be ensured by financial intermediaries. Selection of financial intermediaries within the public procurement procedure was launched in June 2017 and it is currently in the process. Considering need for fund to attract private co-financing as well as progress of the public procurement procedure, it is expected that funds will start investment period in the 2nd or 3rd quarter of 2018.

Per practice of the risk capital industry, investment period for seed, start-up capital and growth capital funds is 5 years, after which follows period of holding of investments, during which funds can make further follow-on investments in portfolio companies. Considering progress of the public procurement procedure and need to attract co-financing from private investors, which means that seed, start-up capital and growth capital funds will start their investment period only in the 2nd or 3rd quarter of 2018 and considering the limited term on the use of ERDF funding until 2023, it is important to diversify financial resources of seed, start-up capital and growth capital funds, **thus ensuring that funds can operate in line with market practices and make further investments in portfolio companies. Therefore, MoE encourages the reduction of currently available ERDF funding for seed and start-up capital funds by 12,800,000 euro and for growth capital funds by EUR 15,000,000, replacing this ERDF funding with recycled public funding in financial instruments.** In addition, it should be noted that availability of recycled funding during investment period will reduce administrative requirements which are determined for the use of ERDF funding.

For acceleration funds allocated ERDF funding is EUR 15,000,000. Considering the novelty of this instrument in Latvia and **with the aim of reducing administrative requirements, the MoE envisage to replace part of ERDF funding in the amount of EUR 2 million with recycled funding** in financial instruments.

table No. 9

Actual division of ERDF financing within the activity 3.1.2.1. and 3.1.2.2. and proposal for reduction (euro)

Financial instrument of activity 3.1.2.1. and 3.1.2.2.	ERDF allotment to date, euro	Proposed reduction of ERDF financing, euro	Result of ERDF, euro
Technology accelerators	15 000 000	-2 000 000	13 000 000
Seed and start-up capital funds	30 000 000	-12 800 000	17 200 000
Growth capital funds	30 000 000	-15 000 000	15 000 000
Total	75 000 000	-29 800 000	45 200 000

5. Access to recycled funds for ensuring of operation of financial instruments

For reducing the ERDF financing in financial instruments mentioned in this report, it is planned to re-allocate financing of recycled funds of financial instrument programs.

Based on demand for the particular product, recycled financing is not subject to the time constraints for using the financing, it can be adjusted according to the existing demand and market situation, and it can facilitate access to the financial instrument by mitigating administrative processes for granting of support set in the EU legislation restricting use of ERDF financing. Partial replacement of ERDF financing with public recycled financial resources is recognized as the most appropriate solution to avoid reduction in volume of financial instruments, and to improve the competitiveness of products: by improving the process of providing support..

Forecasts of planned cash flows of recycled funds are reflected in Annex No. 1 and it shows, that the recycled funds are available in a sufficient amount in order to implement replacement of ERDF financing with recycled funding, mentioned in the informative report.

Conclusions

According to subparagraph 25.1 of the CM Regulations No. 118, the MoE has assessed the situation of the financial market in terms of access to finance for SMEs and has made the following conclusions:

- 1) There are still problems of access to finance and market deficiencies in the SMEs segment, which shows necessity for Altum support programmes; however, in particular segments improvements in ensuring of access to finance for small and medium enterprises can be observed.
- 2) Activity of commercial banks in crediting of resident companies has increased in the period from 2015-2017 in the segment of small loans, and stable increase is estimated also in the next years.
- 3) Activity of commercial banks in granting of small loans to SMEs is significantly promoted by the activity 3.1.1.1 “Loan guarantees”, especially with the introduction of a new cooperation model with commercial banks. We also expect, that in future even greater stimulus to commercial banks in crediting of companies will be given by introduction of portfolio guarantee instrument, as well as availability of InnovFin and Cosme guarantees.
- 4) The long-term operational strategy of Altum provides for slow and gradual transition from direct crediting to indirect market instruments, allowing the market to develop freely. Moreover, the mentioned strategy implies doubling the size of guarantee portfolio, focusing the operation of Altum to the guarantee instrument, which at the same time correlates to stimulation of crediting by commercial banks.
- 5) There is impact of EU legislation restricting use of ERDF funding on administrative procedures and limited time for use of ERDF funding, which in particular limits seed, start-up and growth capital funds to finance follow-on investments in portfolio companies after the end of investment period.
- 6) Reduction of ERDF financing in financial instruments, such as start-up and micro loans, acceleration funds, seed, start-up and growth capital funds, replacing it with recycled funding will improve competitiveness of support programmes and will provide an opportunity to mitigate administrative processes for granting support, thereby making such support more accessible to recipients.
- 7) Risks of non-acquisition of ERDF financing are identified in implementation of business angel co-investment instrument, which is determined by insufficient activity of business angels and the number of investments within the pilot project of Altum and LatBan, which does not justify necessity for introduction of business angels co-

- investment instrument. Unpreparedness of the market for this instrument was also admitted by the European Investment Fund.
- 8) Specific results must be achieved by the end of 2018 in terms of ERDF financing. Taking into consideration the previous results of implementation of programmes, using of recycled financing instead of ERDF financing does not significantly influence achieving of these indicators.
 - 9) To promote access to micro and start-up lending and risk capital instruments, including implementation of seed, start-up and growth capital funds in line with the practice of the risk capital industry and ensuring follow-on investments in portfolio companies after the end of investment period, to facilitate administrative processes related to ERDF funding restrictions and EU regulatory legislation, as well as to avoid risks of non-acquisition of ERDF financing under the business angel co-investment instrument, the MoE proposes to reduce ERDF funding available in financial instruments by 25 416 515 euros, replacing ERDF funding with recycled financing in financial instruments. In turn, given the high demand for the guarantee instrument, the MoE proposes to increase ERDF funding in the loan guarantee instrument by 22 800 000 euro (see Table 10).
 - 10)

table No. 10

Reduction of ERDF financing in financial instruments, proposed by the MoE

Activity	ERDF allotment	ERDF reduction	Result of ERDF, euro	Recycled funding to be allocated, euro
3.1.1.1. "Loan guarantees"	22,000,000	+22 800 00	44 800 000	0
3.1.1.2. "Mezzanine loans"	7,000,000	0	0	0
3.1.1.3. "Business angels co-investment fund"	10,416,515	- 10,416,515	0	0
3.1.1.4. "Micro lending and loans for start-ups"	12,000,000	- 8,000,000	4 000 000	2 500 000
3.1.2.1. "Risk capital"	60,000,000	-27 800 000	32 200 000	27 800 000
3.1.2.2. "Technology accelerators"	15,000,000	-2 000 000	13 000 000	2 000 000
Total	126,416,515	- 25,416,515	101 000 000	32 800 000

6. Impact on the achievement of monitoring indicators for the specific objectives of the action program.

The operational program "Growth and Employment" sets out total and specific results and outcomes in the specific objective 3.1.1 and 3.1.2. In accordance with the program supplement of specific objective 3.1.1. and 3.1.2. of operational program "Growth and Employment" by December 31, 2023, the performance and achievable financial indicators have been set.

Within the framework of specific objective 3.1.1. "Facilitate formation and development of SME's in particular in manufacturing and RIS3 priority industries" and 3.1.2. "To increase number of high growth enterprises", there are several outcome indicators (cumulative), the

value of which is derived from the value of the outcome indicator at the level of 3.1.1. and 3.1.2. the specific objective measures.

Considering the planned redistribution of funding from financial instrument activities to the activity 3.1.1.5, an assessment of the impact on the outcome indicators was carried out:

1. **Indicator's The number of supported entrepreneurs receiving support – 860** entrepreneurs value is the sum of the indicator of financial instrument measures and the values of business incubators and industrial areas activities planned in supporting businesses:

- 1.1. **entrepreneurs receiving financial support other than a grant - total value 790** entrepreneurs, which is formed from the outcome of each individual activity.

Activity	The achievable value by 2023	Actually planned target value ¹⁰
Loan guarantees	114	378
Mezzanine loans	12	12
Microloans and start-up loans	624	400
Business angel co-investment fund ⁷	40	0
Total	790	790

- The initially planned outcome indicator of activity **3.1.1.1. "Loan guarantees"** is 114 supported entrepreneurs.

The value of the indicator was initially determined on the assumption that the planned ERDF funding for the activity is 15 million EUR and the average guarantee amount for one entrepreneur is 0.5 million EUR.

As of June 30, 2017, 163 loan guarantees have been issued totalling 28.3 million EUR, covered by ERDF financing 5.8 million EUR. The average amount of guarantee is approximately 180 thousand EUR, which significantly differs from the originally planned - 500 thousand EUR and as a result, the projected result for 2023 is already exceeded by mid-2017.

By allocating additional ERDF funding of 22 800 000 euro to a loan guarantee program it will contribute to the achievement of indicator, and it is expected that in total the indicator will be 378 supported enterprises. This result is determined on the assumption that in the coming years the amount of individual guarantee will increase because (1) there will be available portfolio guarantees at the beginning of 2018; (2) the use of Innovfin guarantees.

- Initially planned outcome indicator of **3.1.1.2. activity "Mezzanine loans"** is 12 entrepreneurs. Given that the planned redistribution does not affect this measure, this indicator remains unchanged.
- Initially planned outcome indicator of **3.1.1.3. activity "Business angel co-investment fund"** is 40 entrepreneurs. Since this activity is not planned in the near future and all ERDF funding will be reduced, the value of this indicator will not be reached, however, this does not affect achievement of the indicator “1.1. entrepreneurs receiving financial support other than a grant - total value 790“, as the contribution to this indicator is ensured by other financial instruments.

¹⁰ Performance reserve is not taken into account.

- Initially planned funding for activity **3.1.1.4. "Microloans and start-up loans"** is 10.4 million EUR for microloans and 10.4 million EUR for start-up loans considering that the average microloan amount is 20 thousand EUR and start-up loan - 40 thousand EUR.

As of June 30, 2017, 175 start-up loans have been issued totalling of 3.11 million EUR and 45 microloans totalling of 0.56 million EUR within the 3.1.1.4. activity, of which 0.89 million EUR corresponds to ERDF financing. 0.66 million EUR has been spent on management expenses by March 31, 2017. Average amount of start-up loans is 20 thousand EUR and microloan - 13 thousand EUR, which differs from the originally planned average loan amounts.

After the planned redistribution under 3.1.1.4. activity, the available funding for microloans and start-up loans and management costs will be 4 million EUR, of which 1.55 million EUR have already been spent. 0.66 million EUR of planned 3 million EUR for management costs have already been used.

Considering the average amount of one start-up loan and micro loan and use of different financial resources for one loan (ERDF funding is combined with Altum funding), which allows to support a larger number of enterprises, it is predicted that 400 entrepreneurs will be supported in the program. Therefore, initially expected result should be reduced by 224 merchants, which does not affect the achievement of the indicator "1.1. entrepreneurs receiving financial support other than a grant - total value 790" because contribution in exceeding this indicator is provided by other financial instruments.

- 1.2. The number of supported entrepreneurs within 3.1.1.5. activity - 20.** Currently 39 projects have been approved in this activity and all available funding has been used, therefore, it can be assumed that the initially planned outcome rate of 20 supported entrepreneurs will be reached and possibly exceeded.

By increasing ERDF funding in the framework of 3.1.1.5 by 25 million EUR, it is planned that 12 additional entrepreneurs will be supported, if the average project cost would be 2 million EUR. Consequently, **the value of the outcome indicator within the measure should be changed to 32 entrepreneurs.**

- 1.3. Number of supported entrepreneurs within 3.1.1.6 activity - 50.** The planned redistribution does not affect the achievement of this indicator.

Conclusion: Planned redistributions do not significantly affect the achievement of the overall activity program indicator; however, it will be necessary to make some adjustments for indicator "**entrepreneurs receiving financial support other than grants - total value 790**", within the planned values of the indicator at the level of the activity - in the regulatory legal acts, business plan and indicator passport.

- 2. The number of supported start-up entrepreneurs - 308**, which consists of:
 - number of supported entrepreneurs in business incubators - 148 entrepreneurs
 - entrepreneurs supported by the start-up program - 160 entrepreneurs

The value of this indicator is planned to be reached within the framework of 3.1.1.4. activities "Microloans and start-up loans". Given that the beneficiaries of start-up program are newly established companies as of June 30, 2017, 187 start-up loans have already been issued, therefore it is anticipated that this

indicator will be reached and the planned redistribution of funds does not affect the achievement of this indicator.

3. *Attracted private co-financing for public funding (grants) - 21 750 000 EUR*

The redistribution won't decrease indicators value. Accordingly, if 3.1.1.5 activities second round with a provisional ERDF funding of 25 thousand is implemented than the indicator will be increased. Indicatively, it can be concluded that the indicator can be doubled, if attracting up to 40,000,000 EUR.

4. *Attracted private co-financing (not grants) - 12 750 000 EUR*

This indicator was planned to be reached within the framework of 3.1.1.3 activity "Business angel co-investment fund". As the planned redistribution implies that this activity will not be implemented, the indicators planned to be quantified in the framework of 3.1.1.1 activity "Loan guarantees", 3.1.1.2. activity "Mezzanine loans" and 3.1.1.4. activity "Microloans and start-up loans". Considering significant contribution of loan guarantees to the attraction of commercial bank loans, there are no risks to reach this indicator. In addition, in activity 3.1.1.2. "Mezzanine loans" it is planned to attract commercial bank loans in the amount of 22.5 million euro, which already exceeds the indicator threshold.

Conclusion: Regarding indicator attracted private co-financing - 12 750 000 EUR, it is necessary to make changes to the indicator's accounting parameters by establishing that the value of the indicator is derived from 3.1.1.2., 3.1.2.2 activity and 3.1.1.4.activities.

5. *Employment growth in supported enterprises – 827*

3.1.1.6. activity in business incubators - **200 full-time equivalent**. The redistribution of funding does not affect this activity;

- Within the framework of 3.1.1.4. activity - **160 full-time equivalent**.

This indicator was planned to be reached within the framework of 3.1.1.4 activity "Microloans and start-up loans", and it was related to the indicator "The number of supported start-up entrepreneurs", assuming at least one work place is created per entrepreneur. Since the indicator "The number of supported start-up entrepreneurs " is planned to be reached at the originally planned value, the value of this indicator should not be changed;

- Within the framework of 3.1.1.5. activity - **467 full-time equivalent**.

The output indicator values of the first round of 3.1.1.5. activity was determined based on the experience gained from the EU fund 2007-2013 programming period, presuming that the cost of creating one job is 41 000 EUR ERDF funding. It needs to be noted that investment of 3.3.1. specific objective "To increase private investments in regions, by making investments for entrepreneurship development per economic specialization of territories stated in development programmes of municipalities and based on needs of local entrepreneurs" of operational program's "Growth and Employment" priority "Competitiveness of Small and Medium-Sized Enterprises " will also result in investments in the same industrial territories as within 3.1.1.5. activity. It is assumed that this overlap will take place in 50 percent cases. In these cases, market gap is bigger, resulting in an average of 82 000 EUR per created job. As a result, investing 25.1 million EUR from ERDF funding in the manufacturing industry at least 467 new jobs will be created. Accordingly, outcome indicators of second round of 3.1.1.5. activity should be determined by analogy to the first round, thus investing, for example, 25

million EUR from ERDF funding in 3.1.1.5 activities, the values of the indicators would also increase accordingly.

In the specific objective 3.1.1. “To increase number of high growth enterprises” there is determined several output indicators.

1. Number of enterprises receiving support other than a grant – 100 enterprises.

The indicator is aggregated within acceleration funds, seed capital, start-up capital and growth capital funds.

According to the planned redistribution of funding, ERDF financing available for acceleration funds will be 13 million euro. With initial ERDF funding of 15 million euro it was supposed to support indicative 90 entrepreneurs. Considering reduction of ERDF funding in acceleration funds in the amount of 2 million euro, the number of supported enterprises would be reduced proportionally by 12 merchants, reaching the number of supported enterprises in acceleration funds of 78 entrepreneurs.

In seed, start-up and growth capital funds at least 70 entrepreneurs were supposed to be supported with initially planned ERDF funding of 60 million euros. Considering reduction of ERDF funding in the amount of 27.8 million euro, the number of supported enterprises in seed, start-up and growth capital funds would be reduced proportionally by 32 enterprises, reaching the number of supported enterprises of 38 enterprises.

Overall, the indicator in the specific objective 3.1.2. will be exceeded.

2. Number of new enterprises supported - 60 merchants.

It is planned to achieve this indicator in acceleration funds. Considering planned reduction of ERDF funding in acceleration funds of 2 million euro, it is envisaged to support 78 newly created enterprises. Therefore, redistribution does not affect the achievement of this indicator.

3. Private investments matching public support to enterprises (non-grants) – 23 375 000.

The indicator is aggregated within acceleration funds, seed, start-up and growth capital funds. Considering initially planned amount of ERDF funding in acceleration funds of 15 million euro, and initially planned amount of ERDF funding in seed capital, start-up capital and growth capital funds of 60 million euro, it was originally planned to raise amount of private funding (including in the level of investments) indicative at 40 million euro (1,375 million euro in acceleration funds and 38,6 million euro in seed, start-up capital and growth capital funds).

Considering proposed ERDF financing reduction for risk capital instruments in the total amount of 29,8 million euro, planned amount of attracted private co-financing is reduced proportionally. According to new estimates and taking into account available ERDF funding of 45,2 million euro, the amount of private co-financing to be attracted is 24,1 million euro.

Therefore, the indicator “private investments matching public support to enterprises (non-grants) – 23 375 000” will be achieved.

Annex No. 1

Forecasts of planned cash flows of recycled funds from 2017 to 2025

Forecasts of planned cash flows of recycled funds are reflected shows, that the recycled funds are available in a sufficient amount to implement replacement of ERDF financing with repayments.

	Cumulative, thousand EUR	Year 2017	Year 2018	Year 2019	Year 2020	Year 2021	Year 2022	Year 2023	Year 2024	Year 2025
Resources of the MoE Program "Commitments"										
2.2.1.4.1. activity	"Support in form of loans for development of enterprise competitiveness"	5 403	7 602	9 053	9 882	10 171	10 322	10 360	10 368	10 368
	"Support in form of loans for development of enterprise competitiveness" Balance 8014	16 606	18 267	18 746	19 559	19 559	19 559	19 559	19 559	19 559
1.3.1.2. activity	"Support for self-employment and business start-ups"	7 525	7 525	7 525	7 525	7 525	7 525	7 525	7 525	7 525
	ERDF-1	699	699	699	699	699	699	699	699	699
	ESF-1	791	791	791	791	791	791	791	791	791
	Micro-1	560	560	560	560	560	560	560	560	560
2.2.1.1.	Investment fund	0	0	0	0	0	0	0	0	0
2.2.1.4.2.	Mezzanine activity	0	0	0	0	0	0	0	0	0
FOF 3.1.1. and 3.1.2. activities	FoF VCF	0	0	68	319	875	875	3 208	7 063	12 948
	FoF Start	120	440	834	834	834	834	834	834	834
	FoF Micro	28	126	225	468	761	942	942	942	942
	FoF Parallel	4	63	247	652	874	874	874	874	874
	FoF guarantees	0	0	0	0	0	0	0	0	0
DME	DME loans	0	10	91	358	911	1 743	2 211	2 798	4 003
	DME guarantees	0	0	0	0	0	0	0	0	0

Updated market gap assessment in the field of financial accessibility

Total "Commitment"	31 735	36 082	38 838	41 647	43 560	44 725	47 563	52 014	59 103
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**The amounts are shown cumulatively, from the amounts shown in 2017 already actually received 90-95%.*

	Programme name	Year 2017	Year 2018	Year 2019	Year 2020	Year 2021	Year 2022	Year 2023	Year 2024	Year 2025
2.2.1.4.1.	"Support in form of loans for development of enterprise competitiveness"	6 590	9 053	10 461	10 579	10 579	10 579	10 579	10 579	10 579
	"Support in form of loans for development of enterprise competitiveness" Balance 8014	17 905	19 879	20 307	20 454	20 748	21 041	21 335	21 776	21 776
1.3.1.2.	"Support for self-employment and business start-ups"	6 841	7 483	7 569	7 569	7 569	7 569	7 569	7 569	7 569
2.2.1.1.	Investment fund	0	0	0	0	0	0	0	0	0
2.2.1.4.2.	Mezzanine activity	0	0	0	0	0	0	0	0	0
FOF	FoF VCF	0	68	319	875	875	2 401	6 544	12 948	19 969
	FoF Start	0	0	0	0	0	0	0	48	84
	FoF Micro	0	83	157	353	560	582	582	582	582
	FoF Parallel	0	0	0	0	320	320	320	320	320
	FoF guarantees	0	0	0	0	0	0	0	0	0
	Total repayment	33 739	39 026	41 274	42 291	43 336	45 303	50 002	57 301	65 075